ISLAMIC BANKING IN BANGLADESH: PERFORMANCE, PROBLEMS & PROSPECTS

Md. Abdul Awwal Sarker

Islamic banks can provide efficient banking services to the nation if they are supported with appropriate banking laws, and regulations. This will help them introducing PLS modes of operations, which are very much conducive to economic development. It would be better if Islamic banks had the opportunity to work as a sole system in an economy. That would provide Islamic banking system to fully utilize its potentials. Studies show that Islamic banks can not operate with its full efficiency level if it operates under a conventional banking framework, their efficiency goes down in a number of dimensions. The deterioration is not because of Islamic bank's own mechanical deficiencies. Rather it is the efficiency-blunt operations of the conventional banking system that puts obstructions to efficient operation of Islamic banks. This does not mean that the survival of Islamic banks operating within the conventional banking framework is altogether threatened. Evidences from Bangladesh indicate that Islamic banks can survive even within a conventional banking framework by which over from PLS to trade related modes of financing.

The Genesis of Islamic Banking in Bangladesh

At birth, Bangladesh inherited an interest based banking system, which was introduced here earlier when the country was a part of British Colony. Since its inception Bangladesh saw a new trend in banking both at home and abroad. Islamic banking was successfully tries in Egypt. After the Mit Ghamar Model, Naser Social Bank was in the process of establishment. During the seventies, Islamic Development Bank (IDB) and a number of Islamic banks at national levels were established in the Islamic world. At home, the Islamic groups were vigorously working for adoption of Islam as the complete code of life. They found Islamic banking in ready form of immediate introduction. Two professional bodies "Islamic Economics Research Bureau" (IERB) and "Bangladesh Islamic Bankers Association" (BIBA) were taking practical steps for imparting training on Islamic Economics and banking to a group of bankers and arranging some national and international seminars/workshops to mobilize local and foreign people and attract investors to come forward to establish Islamic bank in Bangladesh. Their professional and right-thought activities were reinforces by a number of Muslim entrepreneurs working under the aegis of Muslim Businessman Society 9MBS). The body concentrated mainly in mobilizing equity capital for the emerging Islamic bank. Due to continuous and dedicated work of the above groups and individuals and active support from the Government, Islamic banking could be established in early eighties.

Islamic banks have been operating in Bangladesh for about one and half decade alongside with the traditional banks. Out of over 39 banks only five banks (including one foreign Islamic bank) and two Islamic banking branches of a traditional bank, Prime Bank Limited (PBL) have been working on Islamic principles. Like any other traditional commercial banks, they do mobilize deposits and produce loans. But their modes of operation, based on shariah, is different from the other traditional commercial banks. However, the five Islamic banks operating in Bangladesh are :

Islami Bank Bangladesh Limited (IBBL);

Al Baraka Bank Bangladesh Limited (Al-Baraka);

Al-Arafah Islami Bank Limited (Al-Arafah);

Social Investment Bank Limited (SIBL); and

Faysal Islamic Bank of Bahrain EC (FIBB)

Besides the five Islamic banks , as mentioned, Prime bank Limited has opened two islamic banking branches on 18 December, 1995 and 17th December 1997 respectively while Dhaka Bank Limited has strated operation with an Islamic Counter hand to hand at its Principal office Conjuction with conventional banking operations since inception of the bank on July. 1999.

1 Islami Bank Bangladesh Limited

Islami Bank Bangladesh Ltd., which was incorporated on 14th March, 1983, went into operation on 30th March, 1983 and introduced a full package of banking services in August 1983, Islami Bank Bangladesh Limited is considered to be first interest-bank in South East Asia.

IBBL is a public limited company with limited liability under the companies Act, 1913, it is a joint venture multinational bank with sixty four percent of equity being contributed by the foreign sources. Regarding shareholding structure of the bank, the local shareholders hold shares in the ratio of thirty six to sixty four. In December, 1997 the number of its shareholders stood at 6863, its shares are quoted in the two stock markets of the country namely Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE), Being in high demand the shares are presently sold at three time higher than the face value. Authorized capital of this bank is Tk. 500 million. At present IBBL has a paid-up capital of Taka 317.98 million and Reserve Fund to Taka 930.17 million.

The Bank is managed by 23-member Board of Directors elected by the shareholders, An Extensive committee consisting of 8 Directors and a Management Committee consisting of the top Executives of the Bank also oversee the day-to-day function of the Bank. A representative from the Shariah Council also take part in the above committee. Powers and functions are suitably distributed amongst these bodies. The bank has also a 10 -member Shariah council consisting of Fuquah, Islamic Economists and a Lawyer. The council gives decision on Islamic issues, which are generally followed in the Bank. The Council conducts audits the operation of Bank branches each year on selective basis and put forward report identify the deviations and suggestions for purification of the banking transactions. Besides these committees and Council, types of activities for improvement of the Bank’s overall position.

2 Al-Baraka Bank Bangladesh Ltd.

The second Islamic Bank of the country, Al-Baraka Bank Bangladesh Limited commenced banking business as a scheduled Islamic banks on May, 20, 1987. The Bank is also incorporated under the companies Act of 1913 with registered office in Dhaka it is a joint venture Bank of Al-Baraka investment and Development Company 9ABIDCO) of Jeddah, Saudi Arabia, a renowned financial and business house in the world, Islamic Development Bank, a group of eminent Bangladeshi entrepreneurs and the government of Bangladesh. The authorized capital of the Bank is Tk.600 million dividend into 600,000 ordinary shares of Taka 1,000,00 each . Initially, the paid-up capital of the bank was Taka 150,00 million. To increase the capital of the Bank from Taka 150 million to Taka 300.00 million, the Bank offered right shares at 1.1 ratio to the shareholder on August 01.1992. Consequently, the paid up capital of the bank now stands at Taka 259.553 million shares by the different groups. The Bank has been conducting its all banking operations with 32 branches spreader all over the country. The Bank is managed by a 15-member board of Directs elected by the Shareholders. Since the Board of Al-Baraka Bank cannot meet frequently, the day-to-day affairs of the bank are managed by an Executive Council of 7 Directors. Like IBBL it has a Shariah Council which gives decision on shariah issues.

3 Al-Arafah Islami Bank :Limited:

Al-Arafah Islami Bank Limited was incorporated in June 18, 1995 and started operation as 3rd Islamic bank in the private sector banking in Bangladesh from September 27, 1995. The bank is having an Authorized capital of Tk. 1000 million and paid up capital of Tk. 207.6 million. It renders all types of commercial banking services within the stipulation laid down by banking Companies Act 1991 and directives as received from the Bangladesh Bank from time to time. Bank is managed by 23-member Board of Directors.

The Bank has a 7-member Shariah council consisting of Fuqaha, lawyers and Islamic Economists. The Council gives its advice in order to ensure that the Bank does ntoinvolve any element which is not approved by Islamic Shariah. By August 1998 Al-Arafah Islami Bank opened 21 branches all within the country.

4 Social Investment Bank Limited (SIBL)

Social Investment bank Limited is a fourth Islamic Bank in Bangladesh. It was incorporated on 5th July, 1995 and launched its banking operations of 22nd November, 1995. It nature it is a venture bank of some renowned Islamic organizations of the world and the Government of Bangladesh. At the Operational level, the bank is committed to provide a linkage among the three sectors of the real economy: a) formal sector; b) non-formal sector; and c) Islamic voluntary sector.

The authorized share capital of the bank is Taka 1000.00 million divided into one million shares of Taka 1000.00 each At the end of June 1998 the Paid-up capital of the bank stood at Taka 120.00 million. The bank is managed by a 24-member Board of Directors including three foreign directors and its sub-committee. The bank has also a 8-member Shariah Council consisting of Fuqaha, Islamic Economist and lawyer. The Council gives decision on Islamic issues which are generally followed in the bank. By June 1998 Social Investment Bank has opened seven branches all within the country.

5 Faysal Islamic Bank of Bahrain EC, Dhaka, Bangladesh

Faysal Islamic Bank of Bahrain EC, Dhaka has obtained permission to open its branch in Bangladesh on 6th March 1997. The bank started functioning with effect from 11th August 1997. The principal activities of Bangladesh branch are to provide all kinds of commercial banking services to the customers. All functions of the bank are performed in strict adherence to the principles of Islamic Shariah. In order to ensure such conformity to Shariah, the bank's operations are checked and monitored by its Religious Supervisory Board (RSB) to whom the management reports periodically. In case of new operations and activities, prior approval of the RSB is invariably by the Bank Management. The Bangladesh branch will also be monitoring by the same Shariah Board i.e. RSB.

6 Other Foreign Islamic Banks Branches Operating in Bangladesh

Besides the above branch of Faysal Islamic bank of Bahrain E.C., there are three more branches of three Pakistani Banks have been operating in Bangladesh namely habib Bank Limited, National Bank of Pakistan and Muslim Commercial bank Limited. It may be mentioned that in Pakistan, as in evident in many papers that these banks are operating in accordance with Islamic Shariah. But, unfortunately, here, in Bangladesh, branches of these banks are operating as conventional banks, so their operations have been excluded from the purview of this study. Only the activities of Faysal Islamic bank of Bahrain EC is considered appropriate for this study.

7 Islamic banking in Conventional Banks :

It is appropriate to mention that in the country two conventional banks have taken the initiative of limited Islamic banking activities within their present conventional set-up. These two banks are prime Bank Limited and Dhaka bank Limited. The first one has opened two Islamic banks are Prime Bank Limited and Dhaka Bank Limited. The first one has opened two Islamic banking branches one in Dhaka on 18th December 1997 respectively. The Dhaka Bank Limited had opened an Islamic banking deposit counter at its principal office. Dhaka in 1995 to attract the depositors willing to deposit their money in the interest-free account. But, due to the pressing demand of the customers linked with along with the traditional system.

Prime Bank Ltd. Is the only bank in Bangladesh which is operating branches on both conventional interest-based banking and Islamic shari'ah based banking other traditional banks of the country are being induced by their successful operations to open full-fledged Islamic banking branches. However, at the operational side the operation

of Islami banking branches of Prime Bank Limited are maintained separately from the conventional banking. A shariah Board has also been constituted in order to advise and provide guidance on Islamic banking operations. In order to avoid interest elements of conventional banking a separate set of Accounts are being maintained by the Bank for Islamic banking branches which is completely different from conventional banking branches.

Performance Analysis of Islamic Banks

Performance evaluation is an important pre-requisite for sustained growth and development of any situation. It is customary in commercial banks to evaluate the pre-determined goals and objectives, With the changes goals and objectives, the criteria of revaluation has undergone changes overtime. Regarding performance evaluation of the Islamic banking in Bangladesh "Banking Efficiency Model" has been taken into consideration.

Banking Efficiency Model

Banking Efficiency Model Criteria (five efficiency test criteria) has been developed to measure the efficiency of the Islamic banking system. These criteria are measures and expressed in terms of ratios.

Performance Analysis of the Islamic Banks

As discussed earlier now we are analyzing performance of the Islamic banks by following the Banking Efficiency Model Criteria i.e. five efficiency test criteria to measure the efficiency of the Islamic Banking System of Bangladesh. The discussion deals with the empirical testing of the findings from dynamic analysis to see what is the overall efficiency and performance level of Islamic banks operating within a conventional banking set-up in Bangladesh. Primary Data has been collected from the banks' concerned departments.

1. Productive Efficiency of the Islamic Banks:

Of the five efficiency test criteria enlisted under Productive Efficiency, Investment Opportunity Utilisation Test is one which is described first.

A Investment Opportunity Utilisation Test:

Under production efficiency, we find that fund Utilization Rate (FUR) of IBBL went up progressively from 1989 to 199, by it falls oat 0.75 in 1993 while it was more than 100% in 1996, but again fall to 0.88 in 1997. This is shown at Annexure - I . This rate for Al-Baraka depicts a higher trend after the year 1989 because a hug amount of non-performing assets. Normally this rate will be much below of the present rate. AIBL recorded at 65% for 1996 and 75% for 997. This also depicts an increasing trend in fund utilization. SIBL also recorded this rate at 65%-63% level Islamic banking branches of PBL also utilized their fund by 48.70% in 1996 which falls at 30.23% in 1997, because of their one new branch opened this period. HIBB also depicted a lower rate at 21% only due to investment in limited area.

Per employee deposit mobilisation shows the mixed trend for IBBL, but it came to double in 1997 from 1988. ABBL an other Islamic banks also shows an increasing trend. Per employee fund utilisation also shows the same trend for all banks.

Though relatively better but still below the optimum level of fund utilisation by the Islamic banks was due to competition among them and hard situation of the economy. Th second important reason as considered to be the most important is the borrowers behaviour in making choice between the conventional and Islamic banks.

B Profit Maximisation Test:

All the four indicators o Profitability (viz., Income - Expenditure Ratio, Profit-Expenditure Ratio Profit - loanable fund Ratio and |profit Employed fund Ratio) indicate the IBBL and Al-Arafah experienced declining trend while ABBL and SIBL incurred huge amount of losses for may years.

The declining trend of the above two Islamic banks were due to growing percentages to their investments which were converted into bad debts provisions for classified loans. Among other two banks, ABBL has been incurring losses due to huge amount of non-performing loans while SIBL was making loss during that period due to conflict between owners and Management of the Bank.

C Project Efficacy Test :

How far a bank can contribute effectively in running a projected by it, can be primary determined by the level of linkage in can establish through its financing mechanism. These are:

a Project selection criteria;

b Pre-financing appraisal of projects;

c Post-financing supervision;

d Built-in mechanical linkage of the bank to its financed projects.

Analysis based on the discussion with the Executives of the banks reveals that Islamic banks take utmost attempt for selecting efficient projects but they can not supervise post-financing situation in most of the cases. That's why, a borrower diverted elsewhere and project could be sick and affect recovery of loans. The mark-up based mechanism presently followed by the Islamic banks are essentially not much different from conventional banks in ensuring effectiveness of projects financed by them. It is because of the fact that Islamic banks practices mostly the trade related modes that have little or no relevance to project financing.

A Loan Recovery Test:

It is depicted from an analysis in the central bank that the amount of bad debts of the Islamic banks are growing. The ratio of bad debts to total debts stood at 20% in 1997 from the level of 18% in 1996. However, some new legal provisions are underway for enactment shortly to provide some avenues of overcome acute overdue loan position of the banks.

B Test of Elasticity in Loan Financing:

Loan financing mechanism of Islamic banks in still less elastic. The Islamic banks in the country are facing the problems as they lack suitable modes in meeting call loan demands as well as working capital needs of the entrepreneurs. They also acing problems in inter-bank borrowing due to lack of suitable financing modes.

1 Operational Efficiency of the Islamic Banks:

Two criteria have been used to measure operational efficiency of the Islamic banks. These are : per Employee Administrative Cost (PEAC), and Administrative Cost - Loanable Fund Ratio (ACLFR). Annuxure - II presents this situation. It is seen from the above table that PEAC of all Islamic banks are increasing .PEAC for IBBL in 1998 Taka 91362.00 which reached at Taka 188,807 in 1997. ACLER of the Islamic banks is also denotes an increasing trend.. Though these ratios are increasing, they are stably increasing. So operationally the Islamic banks are good and stable.

2 Allocative Efficiency of the Islamic Banks:

The first component in measuring allocative efficiency is the application of modes of financing. The mode-wise investment situation of the Islamic banks depicts that Annexure - III) short-term trade financing on the basis of mark-up have been extensively used. On the contrary. Musharaka and Mudaraba, the two distinguishing modes where profitability acts exclusively as allocative device, have their declining share in the portfolio distributions of the Islamic banks. Annexure - III of all Islamic banks shows that the investment under Musharaka have declined where there has been a single investment under Mudaraba. So, in allocation of the financial resources the Islamic banks in Bangladesh could never Mudaraba. So in allocation of the financial resources, the Islamic banks in

Bangladesh could never use Mudaraba financing as a tool for investment. The reasons for not using the PLS by the Islamic banks are:

a Under-reporting of profit by the entrepreneurs to evade taxes widely matters to the application of PLS modes since both Mudaraba and Musharaka re profit sharing contracts between the bank and the entrepreneurs, maintenance of proper accounting and declaration of actual profit by the entrepreneurs are extremely essential for the bank. Under-reporting of profit in one of the server moral hazards in Bangladesh. This has been established as rule rather than an exception. As a resuld, entrepreneurs , Interest in Riba free banking prefers making their transactions through modes other than Musharaka and Mudaraba. Islamic banks, for the same reason, appears to be comparatively less important in Bangladesh.

The change in the pattern of financing by the Islamic banks reflects disappointing result in the application of Musharaka mode - a distinguishing feature of Islamic banking. Mudaraba, another mode of financing under PLS could not yet have been attempted by the Islamic banks due to wide apprehension of risks in regard to safe return of capital an profit. However, it is seen from the Annexure - IV that investment in Musharaka financing came down from 3.18% in 1996 to 2.61% in 1997 of IBBL and 2.11% in 1996 to 0.86% in 1997 for SIBL respectively while all other Islamic banks excepting Al-Arafah (investment of Al-Arafah under Musharaka mode stood at Taka 2.51 million or 0.14% of her total investment in 1997) did not make any investment under this operation of Islamic banks in Bangladesh that Utilisation of PLS modes of finance like Musharaka is declining and no investment of the other PLS mode - Mudaraba.

1 Distributive Efficiency of the Islamic Banks:

Three criteria have been applied to measure distributive efficiency. The first deals with for percentage shares of banks gross income going to the banks and the depositors. Profits-income Ratio for the Islamic banks serves as an indicator of the first criterion. The second criterion analyses distribution of deposits and advances to trade out the bias to them.

Profit-income Ratio denotes percentage share of Islamic banks income distributed to the depositors as profit. It is assumed that a high value of the ratio indicates a tendency towards better distribution of incomes generated through the financing process. In case of IBBL, this ratio came down from 23.01% in 1996 to 12.47% in 1997 while this ratio for Al-Arafah went up from 9.16% in 1996 to 31.10% in 1997 respectively. The same for Al-Baraka and social Investment Bank denotes negative sign because Al-baraka has been maintaining provision for huge bad debts loss since 1990. On the other hand, SIBL was in turmoil for conflicting situation prevailed in the bank between the Chairman and the management for the bank for a long period till mid - 1998. But , now the overall situation of Al-baraka and Social Investment Bank have been changing toward better loan discipline and establishment o cooperative atmosphere between the owner and manager. It is reported in the half-yearly Balance-sheet of Al-Baraka for the period June, 1998 that the bank has been able to make profit. SIBL is also marching to reduce their losses. However, it should be noted that, loss of al-Baraka has been reduced to Taka 162.12 million in 1997 from Taka 273.20 million in 1996 and the same has also been reduced incase of SIBL to Taka 5.46 million in 1997 from Taka 1894 million in 1996.

As far as the growth of Deposits of the Islamic Banks in Bangladesh is concerned, the yearly rate of growth of deposits for IBBL was on average 20%. for other Islamic banks this average growth rate were : 10% for ABBL , 300% for Al-Arafah (for strong drive) 140% for SIBL . The two Islamic banking branches of Prime Bank Limited also made remarkable progress in mobilisation of deposits. These two branches had mobilised by 2483.45% or Taka 400.83 million of Taka 416.97 million in 1996 while this growth had slightly fell by Taka 12.74 million in 1997.

The analysis of deposit accounts by size reveals that deposits accounts belongs to account category of Taka 10,000.00 and below represented by 5.84% for IBBL while investment is made to same size of accounts by 0.67|% only. This percentage were : 9.04% for ABBL (investment was 0.001%) , 0.03% for AIBL (investment 0.0001%),0.01% of SIBL (investment 0.01%) while at the deposit range up to Taka

50,000.00, the ratio were : 0.06% for IBBL (investment was 0.01% for SIBL (investment 0.15%). Again if we take an account of 50% of total deposits of the Islamic banks , we find that 50% of the deposits came from the account size up to Taka 300,000.00 and investment was made to them only by 0.03%. That is, Islamic banks in Bangladesh are not exceptional to the current trend of transferring investible resources from the low income depositors to high income borrowers. This of banking equally created more income inequality.

Rural-Urban classification of deposits and advances of bank shows its allocation pattern of financial resources have distributional implications. Due to non-availability of data within this time period, it was not possible to analyse this aspect. However, according to Quarterly Scheduled Banks Statistics, the total distribution of deposits of the banking system by urban-rural areas revealed that this ratio was 77.23 during April-June, 1997 while this Ratio for advances was 82:18 for the same period. Though the report explains the overall position of the banking system, if we deduct the operation of government -owned banks, than the ratio will be very must lower an urban bias of investment will be prominent in the private sector banks, as well as of Islamic banks because their investment operation was basically designed as urban oriented

2 Stabilization Efficiency of the Islamic Banks.

The moral integrity of the entrepreneurs of Bangladesh may be assumed to observe the huge amount of bad debts that have cause serious problem for clean Islamic banking. Moreover, political intervention in selection of borrowers, shock of financial instability, inability of the government of restore low and order in the country, especially framing low regarding the recovery of bad debts etc. have major influence causing to poor implementation in investment projects. In case of Islamic banks, it may be concluded that full dependence on Mark-up based financing would not lead to attain stabilization efficiency, PLS modes of financing may attain this efficiency through collateral-free participatory-based banking.

Problems and Challenges of Islamic Banking in Bangladesh

1. Nature of the Problem and Challenges

The Islamic banks in the world have been facing a number of challenges. Side by side, the Islamic banking in Bangladesh is also facing numerous problems of challenges. First, they have not yet been successful in devising an interest-free mechanism to place their funds on a short-term basis. They face the same problem in financing consumer loans and government deficits. Second, the risk involved in profit-sharing seems to be so high that almost all of the Islamic banks in Bangladesh have resorted to those techniques of financing which bring them a fixed assured return. As a result, there is a lot of genuine criticism that these banks have not abolished interest but, they have, in fact, only changed the nomenclature of their transactions. Third, the Islamic banks do not have the legal support of the Central bank in Bangladesh, do not have the necessary expertise and trained manpower to appraise, monitor, evaluate an audit the projects that are required to finance. As a result, they can not expand despite having huge excess financial liquidity.

The implementation of an interest-free banking in Banking raises a number of questions and potential problems which can be seen from the macro and micro operational point of view. A partial list of the issues confronting Islamic banks in Bangladesh include:

2. Problems Related to Macro Operation of the Islamic Banks

1 Liquidity and Capital

2 Valuation of bank Assets

3 Financial Stability

4 The Ownership of Banks

5 Lack of Capital Market and Interest-free Financial Instruments

6 Insufficient Legal protection

7 Controlling and Supervision by the Central bank on the Basis of Islamic Shariah

8 Lack of Unified Shariah Rulings

9 Absence of Islamic Inter-Bank Money Market

10 New Banking Regulations

11 Accounting principles and Procedures

12 Shortage of Supportive and Link Institutions

13 Shortage of Skilled and Trained Manpower in Islamic Shariah banking

14 Lack of Co-operation among the Islamic Banks

15 Lack of Familiarity by International Financial and Non-financial Sector with Islamic Products and procedures.

16 Severe Competition in the Financial Sector

17 Economics slowdown and Political Situation of the Country

18 Inadequate Track Record of Islamic Banking

19 Absence of Infrastructure for International Islamic Trade Financing

20 Defaulting Culture of the Borrowers

21 Short-term Asset Concentration in the Islamic Banks

22 Lack of Course or paper on Islamic Economics, Banking and Finance at the Educational Institutions.

23 Lack of Uniform Operational procedure of Islamic Banking

24 Lack of Specialised Islamic Banks and Non-Bank financial Institutions

25 Lack of Consortium or Syndication of the Islamic Banks

26 Lack of Harmonization of Islamic financial Practices

27 Lack of Inter-country Study on the practical Operations of Islamic Banking

28 Lack of Secondary Securitisation Market

29 Lack of Coordinated Research Work on Islamic Economics, Banking and finance

30 Lack of Apex Training Institute for the Islamic Banks.

3. Problem Related to Micro Operation of the Islamic Banks :

1 Increased Cost of Information

2 Control over Cost of Funds.

3 Mark-up Financing and Corrupted Mark-up

4 Excess Resort to the Murabaha Mode of Financing

5 Utilization of Interest Rate of fixing the Profit Margin in Bai-Modes

6 Financing Social Concerns.

7 Lack of Positive Response to the Requirement of government Financing.

8 Failure of Islamic Banks to Finance High Return Projects.

9 Sacrifice of allocative Efficiency

10 Loss of Distributive Efficiency.

11 Depression of Profit.

12 Lack of Full-fledged Shariah Audit.

13 Fraud-Forgery or corruption in Islamic Banks.

14 Minimum Budget for Research and Development.

15 Working Environment.

16 Issuance of Letter of Guarantee (L/G)

17 Minimum Budget for Research and Development.

18 Lack of Shariah Manual or Guidelines.

19 Islamic Investment Risk Analysis and measurement Methodology.

20 Non-exemption of Stamp Duty for Purchasing Property by Banks.

21 Lack of Co-operation between Islamic Banks and Islamic NGOs for extending Micro-credit.

22 Lack of Establishment of Links with other Training Institutes and Shariah Supervisory Bodies.

23 Lack of Intention of the Management to be strict with Shariah Guidelines.

The above problems are some of the burning problems confronting the Islamic banks in Bangladesh. However it is felt that much operational work and in-depth research work has to be undertaken to allow the Islamic banks to flourish with highest quality and strength.

The Future of Islamic Banking in Bangladesh

1. Need for Re-organization of the Whole financial System

Review of the problems of Islamic banking in general and Islamic banks of Bangladesh in particular poses a challenging feature for the promotion and survival of Islamic banks in Bangladesh. The policy implication is not that Islamic banks should never be floated within the conventional banking framework. Rather it is the conventional banking system whose operational mechanism needs to be re-examined and converted into PLS system considering beneficial impact of the latter on the economy. However, as long as Islamic banks are to operate within the conventional banking framework, the recommendations under the following heads may be taken note of.

2. New banking philosophy for the Islamic Banks

There seems to be a gap between the ideals and actual practice of Islamic banks in Bangladesh. In their reports, booklets, bulletins and posters there banks express their commitment to striving for establishing a just society free from exploitation. Study shows that a little progress has been achieved so far in that direction. Though this failure is attributed mainly to the pervasive influence of conventional banking system itself, lack of vigilance of the promoters of Islamic banking in realizing the objective is no less to blame. There should be a through review of policies that have been pursued by these banks for about a decade and points of departure have to be identified to redesign their of action.

3. Future Policy and Strategy

The first action that deserves immediate attention is the promotion of the image of Islamic banks as PLS banks. Strategies have to be carefully devised so that the image of Islamic character and solvency as a bank is simultaneously promoted. To this end, Pilot schemes in some very selected areas should be started to test innovative ideas with profit-loss-sharing modes of financing as major component. Islamic banks should clearly demonstrate by their actions that their banking practices are guided by profitability criterion thereby establishing that only Islamic banking practices ensures efficient allocation of resources and provide true market signals through PLS modes. Islamic banks should continuously monitor and disseminate through various means the impact of their operations on the distribution of income primarily between the bank and the other two parties: the depositors and the entrepreneurs, and then on different income groups of the society. These presuppose establishment of a fully equipped research academy in each Islamic bank.

4. Stepping for Distributional Efficiency.

The task is more challenging for Islamic banks, as they have toe promote their distributional efficiency from all dimensions together with profitability, Islamic banks, step by step, have to be converted into profit-loss-sharing banks by increasing their percentage share of investment financing though PLS modes. The Islamic banks, to do that, can be selective in choosing clients for financing under PLS modes. They should establish direct functional relationship between the income of the depositors and between the income the income of the bank and that of the entrepreneurs. The relationship improves with share of bank financing under PLS modes increases.

5. Promotion of Allocative Efficiency

The Islamic banks can improve their allocative efficiency be satisfying social welfare conditions in the following manner. First , they should allocate a reasonable portion of their investible funds in social priority sectors such as agriculture (including poultry and fishery), small and cottage industries and export-led industries like garment, shrimp cultivation. Secondly, when the percentage shares of allocation of investible funds are determined among the sectors of investment financing, profitability of projects should be the criterion for allocating investment funds. The criterion would be best satisfied if more and more projects were financed under PLS modes.

6. Modern banking Policies and practices

Islamic banks, with a view to facing the growing competition either fellow-Islamic banks or the conventional banks which have launched Islamic banking practices, will have to adapts their functioning in line with modern business practices, though improvement and expansion of the range of dealing in the banking sector. Thus, it is necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthroughs in areas such as electronic communication , computerization etc.

7. Government and Central bank Responsibilities

Government should think actively for the promotion of Islamic banking in Bangladesh considering its pro-development role. It should amend existing financial laws, acts and regulations to create favorable environment conducive to smooth operation of Islamic banks. The bank Reforms Committee may be entrusted to draft an Islamic Banking Act. Government should also allow establishment of Islamic insurance and other subsidiary companies in order to facilitate their operation. Bangladesh Bank should develop some Islamic Monetary and Saving instruments and create separate window for transactions with the Islamic banks and a full-fledged Islamic banking Department for analyzing, supervising, monitoring and guiding purpose, thereby facilitating Islamic banks for their smooth development in Bangladesh.

8. Inter-Islamic Bank Co-operation and Perspective Plan

All Islamic banks should come forward to help each others and adopt a perspective plan say for 20 years for Islamization of the banking system of Bangladesh. To actualize this mission, they should set-up immediately andApex Research Adademy and a Training Institute designed with modern tools. Books and other accessories.

Conclusion and Implication

1. Islamic banks can provide efficient banking services to the nation if they are supported with appropriate banking laws, and regulations. This will help them introducing PLS modes of operations, which are very much conducive to economic development. It would be better if Islamic banks had the opportunity to work as a sole system in an economy. That would provide Islamic banking system to fully utilize its potentials. Studies show that Islamic banks can not operate with its full efficiency level if it operates under a conventional banking framework, their efficiency goes down in a number of dimensions. The deterioration is not because of Islamic bank's own mechanical deficiencies. Rather it is the efficiency-blunt operations of the conventional banking system that puts obstructions to efficient operation of Islamic banks. This does not mean that the survival of Islamic banks operating within the conventional banking framework is altogether threatens. Evidences from Bangladesh indicate that Islamic banks can survive even within a conventional banking framework by which over from PLS to trade related modes of financing.

2. Even under the conventional banking framework Islamic banks can operate with certain level of efficiency by applying in a reasonable percentage the PLS modes. The distinguishing features of Islamic banking. This has been possible in some countries of the Muslim world where the management of Islamic banks was cautious about possible impacts of every policy measure. Particularly, the management of these banks was judicious in selecting sectors or areas as major of their operations. Sudan Islamic banks is a typical example in this respect. Islamic banks in Bangladesh have much to learn from the experience of this successful Islamic bank.

3. Having been considered the pro-efficiency character of Islamic banking and its beneficial impacts on the economy, government policy in Bangladesh should be in favour of transforming conventional banking system into Islamic banking. It is reasonable to assume that risks involved in Mushraka or Mudaraba financing are different from those involved in trade-type financing. It follows, therefor, that prudential regulations of these transactions should be different.

4. Determination of profit and loss in profit/loss sharing arrangement and treatment of costs and reserves in such accounting is a pertinent issue to be addressed with utmost importance and priority. However, Islamic banking is a very critical institution to materialize the economic objectives of Islam. It should however, be noted that it is ot the

whole of the Islamic framework. Compared to the conventional banks it is very much viable by itself, but the full impact of it can only be realized by supplementing it with corresponding reforms in other spheres of life in general, and in the monetary and fiscal fields in particular.

Finally, it may be mentioned that if the Islamic financial system, is to become truly liquid and efficient it must develop more standardized and universally (or at least widely) tradable financial instruments. The development of a secondary financial market for Islamic financial products is crucial if the industry is to achieve true comparison with the conventional system. It must also work hard to develop more transparency in financial reporting and accounting and ideally - a form of Islamic GAAP. Development if the whole sale and especially inter-bank and money markets, will be the key to Islamic finance growing outside its current little sphere of influence, and becoming a truly national invigorating force.

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Annexure- I

Productive Efficiently of the Islamic Banks
Name of the Bank: Islamic bank Bangladesh Ltd.

Particulars	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
1. Deposits	2825.43	3455.53	4462.71	5671.61	6703.78	8261.08	10226.66	12669.33	14027.08	16557.29
2. Bills payable	-	-	-	-	-	-	-	-	-	-
3. Borrowing from other banks & agents	-	-	-	-	-	-	-	-	-	-
4. Borrowing from Bangladesh bank	-	-	-	-	-	-	-	-	-	-
5. Loanable funds	2542.88	3109.97	4016.43	5104.44	6033.40	7434.97	9203.99	11402.39	12624.37	14901.56
6. Fund employed (Advances)	2132.38	2358.44	3252.47	4245.62	5164.16	5542.50	8076.50	11532.82	13539.35	13095.31
7.No. of employees	690	843	840	991	1057	1169	1166	1350	1778	1903
8.Fund utilization rate(%)+(6/5)100	0.83	0.76	0.81	0.83	0.86	0.75	0.88	1.01	1.07	0.88
9. Per employees deposit mobilization "000" Tk	4095	4099	5313	5723	6342	7067	8771	9385	7889	8701
10. Per employees fund utilization in "000"Tk.	3090	2798	3872	4284	4886	4741	6927	8543	7615	6881

Annexure- I

Productive Efficiently of the Islamic Banks
Name of the Bank: Al Baraka Bank Bangladesh ltd.

Particulars	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1. Deposits	2	3	4	5	6	7	8	9	10	11
2. Bills payable	1966.50	3500.80	3857.20	3058.90	3437.30	3822.10	4747.50	4754.90	5880.60	6401.86
3. Borrowing from other banks and agents	5.66	16.86	24.96	14.95	17.47	26.40	33.82	51.87	22.05	35.24
4. Borrowing from Bangladesh bank	- -	- -	- -	- -	- -	- -	- 1100.00	- 800.00	- 150.00	- 560.00
5. Loanable funds	1769.85	3150.72	3471.48	2753.01	3093.57	3439.57	3439.89	4272.75	4279.41	5761.67
6. Fund employed (Advances)	1439.40	3230.90	3654.30	3030.20	3983.20	4276.50	4556.10	4369.90	4277.20	4965.09
7.No. of employees	384	592	673	669	618	618	598	609	637	632
8. Fund utilization rate(%) + (6/5) 100	0.81	1.02	1.05	1.10	1.28	1.24	1.06	1.02	0.80	0.86
9. Per employees deposit mobilization "000" Tk	5121	5914	5731	4572	5562	6185	7939	7808	9232	10129
10. Per employees fund utilization in "000"Tk.	3748	54578	5429	4529	6445	6920	7619	7176	6715	7856

Annexure- I

Productive Efficiency of the Islamic Banks

Name of the Banks:

1 Al-Arafah Bank Islami Bank Ltd.

2 Social Investment Bank Ltd.

3 Prime Bank Ltd.

4 Faysal Islamic Bank of Bahrain EC.

Particular	Al-Arafah IB Ltd.		Social IB Ltd.			Prime bank Ltd			FIBB EC.
	1996	1997	1995	1996	1997	1995	1996	1997	1997
1	2	3	4	5	6	7	8	9	10
1. Deposits	1305.6	2251.99	124.72	417.81	645.52	16.14	416.97	621.29	200.48
2. Bills Payable	26.74	91.63	0.09	12.85	11.03	0.18	0.82	0/.40	-
3. Borrowing from other banks and agents	-	-	-	-	-	-	331.11	225.90	-
4. borrowing from Bangladesh bank	-	-	-	-	-	-	-	-	-
5. Loanable funds	1199.1	2343.62	112.25	376.03	580.96	11.29	291.9	283	200.48
6. fund employed (Advances)	779.15	1745.54	0.21	211.5	368.31	-	142.14	102.54	-
7. No. of Employees	171	320	61	166	167	12	11	22	22
8. Fund Utilization rate (5)=(6/5) 100	65%	75%	0.19	56.24	63.39	-	49%	36%	21
9. Per employee deposits mobilization "000"Tk.	7.64	7.04	2045	2517	3865	1345	3790	2824	9.11
10. Per employee fund utilization in"000" Tk.	7.56	5.46	3	1274	2205	-	44	16	1.91

Annexure- II

Operational Efficiency of the Islamic Banks
Name of the Bank; Al Baraka banks Bangladesh Ltd.

Particulars	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
1. Administrative Cost	36.33	71.47	92.01	92.19	91.16	89.82	92.62	91.68	138.41	138.24
2. Investment (Loanable Fund)	1439.40	3230.90	3654.30	3030.20	3983.20	4276.50	4556.10	4369.90	4277.20	4965.09
3. No. of Employees	384	592	673	669	618	618	598	609	637	632
4. Per Employee Administrative Cost	0.95	0.121	0.137	0.138	0.148	0.145	0.155	0.151	0.217	0.219
5. Administrative Cost Loanable fund Ratio	0.25	0.022	0.025	0.030	0.023	0.021	0.020	0.021	0.032	0.028

Annexure - II

Operational Efficiency of the Islamic Banks
Name of the Bank: Islami bank Bangladesh Ltd.

Particulars	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
1. Administrative Cost	63.04	89.58	104.70	138.41	176.25	192.43	205.64	248.52	297.78	359.30
2. Investment (Loanable Fund)	2542.88	3009.97	4009.97	4016.43	5104.44	6033.40	7434.97	11402.39	12624.37	14901.56
3. No. of Employees	690	843	840	991	1057	1169	1166	1350	1778	1903
4. Per Employee Administrative Cost	0.091	0.106	0.125	0.140	0.167	0.165	0.176	0.184	0.167	0.189
5. Administrative Cost Loanable fund Ratio	0.25	0.029	0.026	0.027	0.029	0.026	0.022	0.022	0.024	0.024

Annexure - II

Productive Efficiency of the Islamic Banks

Name of the Bank:

1 Al-Arafah bank Islami bank ltd.

2 Social Investment bank Ltd.

3 Prime bank ltd.

4 Faysal Islamic bank of Bahrain EC.

Particular	Al-Arafah IB Ltd.		Social IB Ltd.				Prime bank Ltd	FIBB EC.
	1996	1997	1995	1996	1997	1996	1997	1997
1	2	3	4	5	6	7	8	10
1. Administrative Cost	30.08	56.45	6.15	31.39	35.74	1.38	2.23	7.69
2. Investment (Loanable Fund)	435.20	750.00	0.21	21.50	368.31	291.90	283.00	200.48
3. No. of Employees	171	320	61	166	167	11	22	22
4. Per Employee Administrative Cost	0.176	0.176	0.101	0.189	0.214	0.125	0.101	0.350
5. Administrative Cost Loanable fund Ratio	0.069	0.075	29.286	0.148	0.097	0.005	0.008	0.038

Annexure III

Portfolio Structure of Financing by the Islamic Banks
Name of the Bank: Al Baraka bank Bangladesh Ltd.

Particulats	1988	1989	1990	1991	1992	1993	1994	1995
1	2	3	4	5	6	7	8	9
1. Short term financing (TDR)	591.80	1627.63	2147.58	2454.43	3116.16	3075.16	3107.55	3777.21
2. Term financing (Musharaka, Hire Purchase)	2090.41	552.88	658.15	720.93	318.89	320.52	322.40	350.69
3. Trade financing (Murabaha, Bai-muajjal	1086.74	1227.48	1709.26	782.86	2075.85	2153.68	2085.30	2075.48
4. Investment in Govt. Securities Term Bills other approved secirities et	-	-	-	-	-	-	-	-
5. Others	-	-	-	-	-	-	-	-
Total:	3768.95	3407.99	395822	5510.90	5510.90	5549.36	5515.25	6203.38

Annexure - III

Portfolio Structure of Financing by the Islamic Banks
Name of the Bank: Islamic Bank Bangladesh Ltd.

Particulats	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
1. Short term financing (TDR)	-	-	105	6	183	219	291	410	584	629
2. Term financing (Musharaka, Hire Purchase)	177	373	536	710	760	959	1297	2123	2680	3023
3. Trade financing (Murabaha, Bai-muajjal	1566	1725	2026	3036	3768	4151	5769	8152	9277	8161
4. Investment in Govt. Securities Term Bills Other approv. securities et	59	59	59	21	21	21	21	21	21	20
5. Others	389	200	-	368	432	584	698	827	977	1262
Total:	2191	2357	2726	4141	5164	5934	8076	11533	13539	13095

Annexure - III

Portfolio Structure of Financing by the Islamic Banks

Name of the Bank:

1 Social Investment Bank Ltd.
2 Prime bank Ltd.
3 Faysal Islamic Bank of Bahrain

Particular	Social IB Ltd.			Prime bank Ltd		FIBB EC.
	1995	1996	1997	1995	1996	1997
1	2	3	4	5	6	7
1. Administrative Cost	-	13.96	26.86	4.18	1.57	-
2.Investment (Loanable Fund)	-	56.57	76.78	123.72	97.99	-
3. No. of Employees	0.21	11.4	232.76	8.43	2.02	34.46
4. Per Employee Administrative Cost	-	19.11	1.23	-	-	-
5. Administrative Cost Loanable fund Ratio	-	10.46	30.68	5.85	-	7.54
Total	0.21	211.50	368.31	142.18	101.47	42.00

Annexure - IV

Mode-Wise Investment of the Islamic Banks
Name of the Bank: Baraka Bank Bangladesh ltd.

Mode1996	1997									
1	2	3	4	5	6	7	8	9	10	11
1.Murabaha	1226	1140	1360	2143	2739	3020	4304	6163	6798	5559
2. Musharaka	83	64	71	99	117	190	283	445	430	342
3. Bai-Muazzal	340	586	666	893	1029	1131	1465	1989	2479	2602
Hire Purchase	94	309	465	611	643	768	1014	1678	2252	2681
5. Quard-e-Hasana (PF &Bf)	-	-	4	6	183	220	291	410	583	629
6. Quard-e-Hasana (TDR)	-	-	101	-	-	-	-	-	-	-
7. Purchase & Negotiation	280	140	-	368	432	584	698	827	976	1262
8. Investment in Share & Securities	59	59	59	21	21	21	21	21	21	20
9. Others	109	60	-	-	-	-	-	-	-	-
Total:	2191	2358	2726	4141	5164	5934	8076	11533	13539	13095

Annuxure - IV

Mode-Wise Investment of the Islamic Banks

Name of the Banks:

1 Al-Arafah bank Islami Bank Ltd.

2 Social Investment Bank Ltd.

3 Prime bank Ltd.

4 Faysal Islamic bank of Bahrain EC.

Particulars	Al-Arafah IB Ltd.		Social IB Ltd.			Prime bank Ltd		FIBB EC.
	1996	1997	1995	1996	1997	1996	1997	1997
1	2	3	4	5	6	7	8	9
1.Murabaha	263.60	485.26	0.21	79.26	195.87	5.70	0.87	34.46
2. Musharaka	-	2.51	-	4.51	3.21	-	-	-
3. Bai-Muazzal	95.40	191.64	-	30.06	36.89	2.80	1.12	-
Hire Purchase	20.00	54.57	-	68.04	73.57	123.72	97.88	-
5. Quard-e-Hasana (PF &Bf)	3.60	0.40	-	-	-	-	-	-
6. Quard-e-Hasana (TDR)	19.30	161.16	-	13.96	26.86	4.18	1.57	-
7. Purchase & Negotiation	-	-	-	5.15	1.17	0.89	1.10	-
8. Investment in Share & Securities	-	28.36	-	0.06	0.06	-	-	-
9. Others	384.00	867.30	-	10.46	30.68	4.96	-	7.54
Total:	785.90	1791.20	0.21	211.50	368.31	142.25	102.54	42.00

Annexure - V

Performance of the Islamic Banks
Name of the bank : Islami Bank Bangladesh Ltd.

Mode	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
Authorised Capital	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00
Paid-up Capital	79.50	79.50	160.00	160.00	160.00	160.00	160.00	160.00	315.69	317.98
Reserve fund	59.82	64.17	92.28	113.43	139.65	209.36	303.57	535.08	759.39	930.17
Deposit	2837.75	3455.52	4462.71	5671.61	7150.80	8261.08	10226.66	12699.33	14027.08	16557.29
Investment	2015.30	2358.43	3252.47	4283.12	5164.16	5542.50	8076.49	11532.82	13539.35	13095.31
Import Business	2132.38	3394.90	3917.70	6204.27	8778.51	8612.70	14623.43	21218.38	17874.80	17370.00
Export Business	2015.30	1543.80	2588.30	3966.58	4948.81	5841.64	7790.42	11015.75	11766.40	14469.40
Remittance	1349.40	901.60	1339.90	1814.13	2028.59	2402.51	2943.00	2447.21	3328.30	4806.00
Total Income	232.88	285.81	452.26	541.80	527.05	622.89	826.56	1097.61	1232.35	1368.77
Total Expenditure	202.21	263.22	311.70	436.04	527.05	542.89	603.98	786.25	948.83	1198.02
Net Profit Before Tax	30.67	22.59	140.56	105.76	-	80.00	222.58	311.36	283.52	170.75
Profit after Reserve to Tax	11.93	10.34	24.00	24.00	-	24.00	24.00	28.80	63.60	66.78
Payment of Govt. (Income Tax)	11.05	7.73	88.44	55.61	-	40.00	139.07	162.90	127.58	68.30
Dividend	15%	13%	15%	15%	-	15%	15%	18%	20%	21%
Total Assets	4030.20	5184.68	6677.19	9382.84	11695.75	13528.31	18498.44	22990.59	22746.48	26826.60
Fixed Assets	21.89	25.83	30.95	31.58	35.08	44.78	42.27	51.90	89.82	143.19
Number of Foreign correspondents	140	201	248	291	395	436	450	495	525	610
Number of Shareholders	5691	5516	5636	5480	5335	5453	5453	5803	5924	6863
Number of Employees	690	843	840	991	1057	1169	1166	1350	1778	1903
Number of Branches	27	40	49	61	71	76	83	90	95	100
Average Employee per Branch	26	21	17	16	15	15	14	15	19	19

Annexure -V

Performance of the Islamic Banks
Name of the Bank: Al-Baraka Bank Bangladesh Ltd.,

Mode	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1	2	3	4	5	6	7	8	9	10	11
Authorised Capital	600.00	600.00	600.00	600.00	600.00	600.00	600.00	600.00	600.00	600.00
Paid-up Capital	131.20	150.0	150.00	150.00	151.50	204.00	259.50	259.50	259.50	259.50
Reserve fund	4.20	15.90	15.90	15.90	15.90	15.90	15.90	15.90	15.90	15.90
Deposit	1,966.50	3,500.80	3,058.90	3,058.90	3,437.30	3,822.10	4,747.50	4,754.90	5,880.60	6,401.86
Investment	1,439.40	3,230.90	3,203.90	3,030.20	3,983.20	4,276.50	4,556.70	4,369.90	4,277.20	4965/09
Import Business	1,691.00	1,891.00	1,891.00	219.87	230.38	1,074.00	2,095.20	1,185.40	2,231.88	2,694.10
Export Business	69.50	165.46	165.46	212.72	171.18	145.36	172.02	259.51	254.78	542.08
Remittance	-	357.10	357.10	99.91	338.44	413.34	210.57	464.34	244.66	245.60
Total Income	132.20	311.70	485.10	409.70	382.70	368.20	248.10	193.10	203.50	368.01
Total Expenditure	102.80	262.70	484.20	510.50	466.10	415.20	439.20	432.80	476.77	530.13
Net Profit Before Tax	29.40	49.00	0.90	100.80	83.40	47.00	191.10	249.90	273.90	162.12
Profit after Reserve to Tax	9.91	0.07	-	100.80	83.40	47.00	191.10	249.90	273.90	162.12
Payment of Govt. (Income Tax)	18.18	37.78	0.49	-	-	-	-	-	-	-
Dividend	-	-	-	-	-	-	-	-	-	-
Total Assets	2,811.95	5,735.40	6,102.18	5,309.30	5,246.98	6,076.28	6,833.47	6,385.10	7,283.24	8,015.36
Fixed Assets	24.29	43.16	39.19	36.65	37.92	37.71	35.56	37.81	39.75	51.43
Number of Foreign correspondents	99	107	108	94	80	83	90	108	108	108
Number of Shareholders	21	17,835	5,424	3,337	2,678	2,612	2,534	2,212	2,166	N. A.
Number of Employees	384	592	673	669	618	618	598	609	637	637
Number of Branches	10	18	22	23	26	28	28	32	33	33
Average Employee per Branch	38	33	31	29	24	22	21	19	19	19

Next